Attachment 1

WILSHIRE CONSULTING

Andrew Junkin, CFA, CIMA, CAIA
Managing Director & Principal

September 2, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Domestic Equity Contract Renewal Recommendation[1]

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendations pertaining to the annual review and renewal of the contracts of the domestic equity managers. Staff is recommending renewal of the contracts for all existing external domestic equity managers.

Recommendation

Wilshire recommends that the Investment Committee approve the renewal of the domestic equity external managers' contracts. As always, Staff has the right to terminate the contracts with a pre-specified notice period should performance or organizational issue arise that would warrant termination. In addition, we recommend that Staff examine the possibility of implementing strategies with small cap, mid cap, or SMID (small & mid) cap mandates.

Discussion

During fiscal year 2008, the domestic equity external manager program underperformed its benchmark, lagging the composite benchmark by 58 basis points. During the fiscal year, Staff restructured the externally managed portfolio to concentrate on managers that have investment processes that cannot be replicated within CalPERS and to minimize overlapping strategies. The program now consists of twelve managers: five active managers, four 130/30 managers, and three enhanced index managers. Two of the

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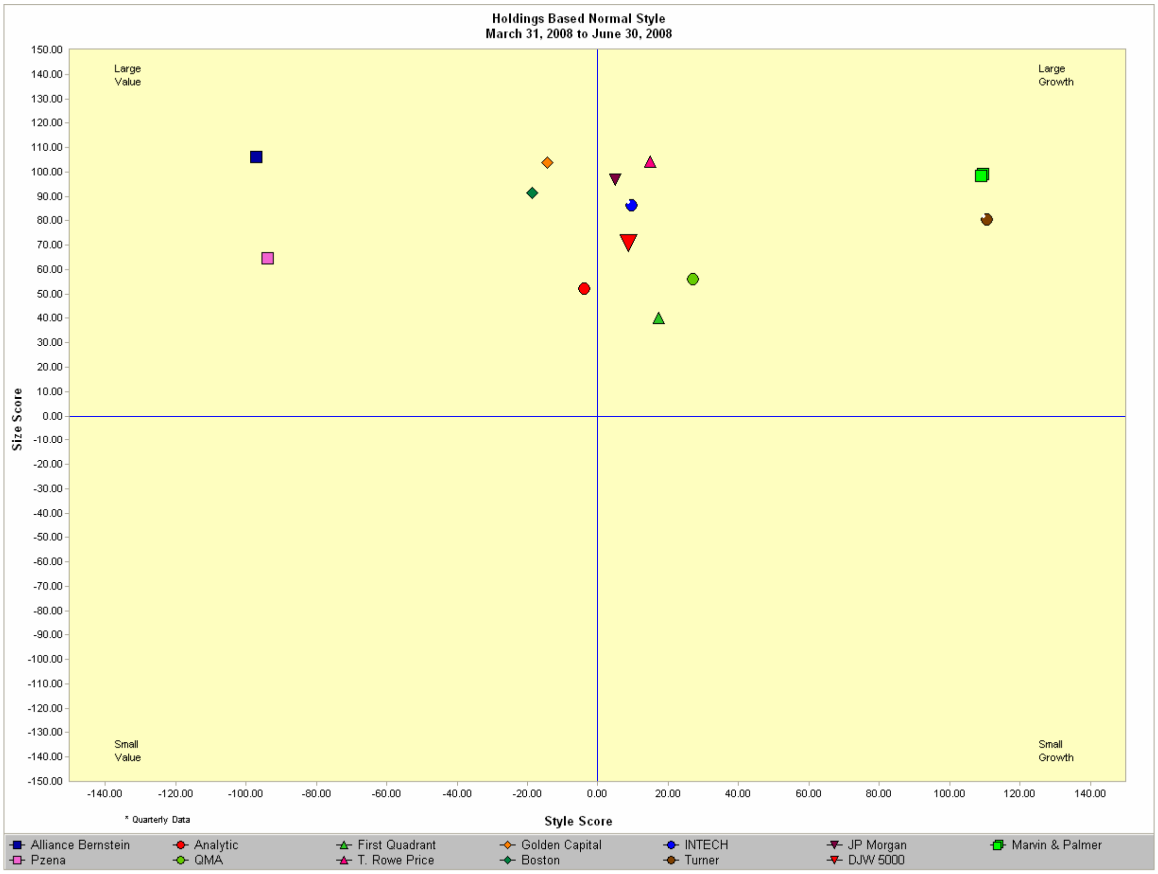
[1] Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover.

130/30 managers (First Quadrant and JP Morgan) were funded in the 4th quarter of the fiscal year.

We support the annual contract renewal recommendation. Staff has the authority to terminate managers who do not perform as expected, and they have used that authority when necessary and appropriate. The renewal of these contracts does not in any way preclude Staff from exercising the authority to terminate any manager who ceases to perform as expected subsequent to contract renewal. Manager-specific comments are provided below, beginning on page 11.

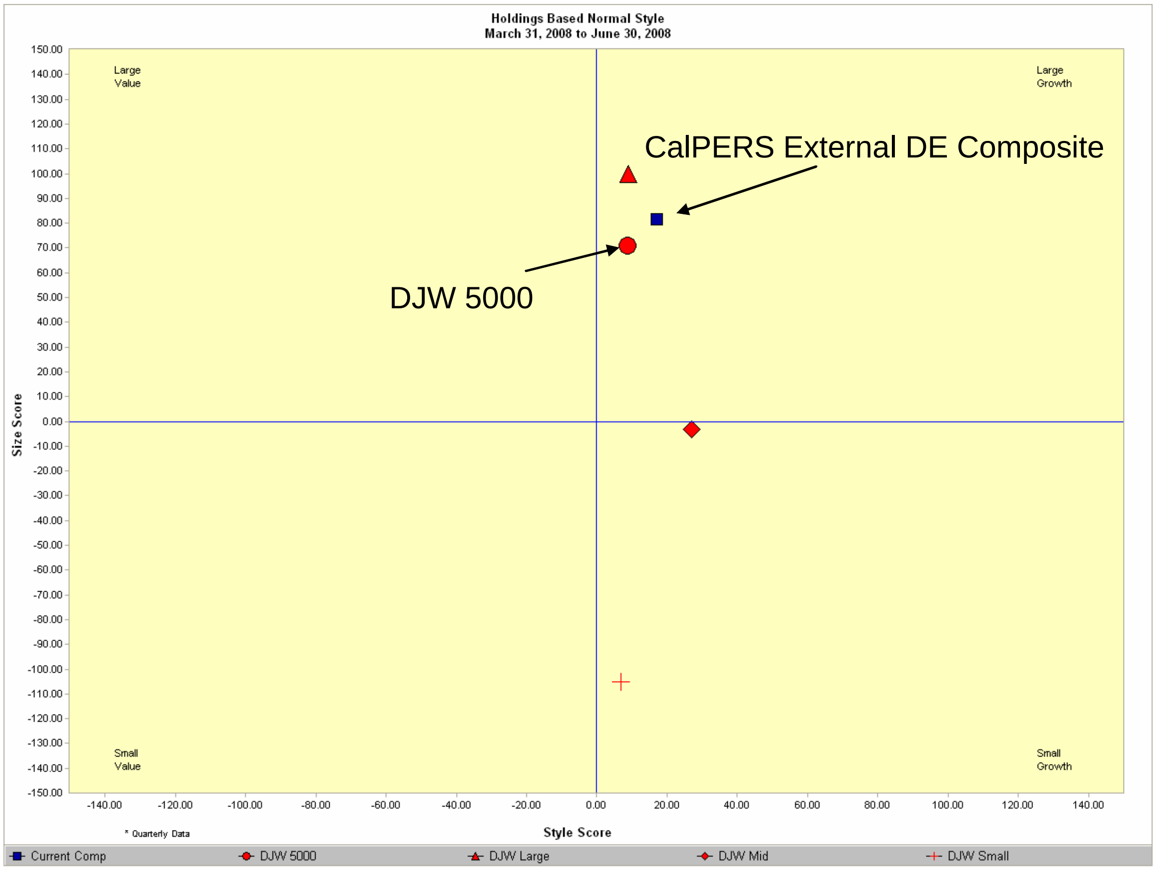
Additionally, Wilshire recommends that Staff investigate adding active managers in the small cap, mid cap, and SMID cap spaces in the domestic equity market. In the past, the size of the Global Equity portfolio and the size of the external program have acted as constraints on the ability to invest in smaller cap mandates. As an example, many small cap products close due to capacity concerns when assets under management reach $2 billion – mid cap and SMID cap generally have higher capacity limits. Our recommendation is based on three key factors: 1) the externally managed portfolio has a distinct large cap bias, compared to the overall US equity market, 2) the small cap, mid cap and SMID cap segments of the US equity market are generally less efficient than the large cap segments, making it more likely that active management can add value, and 3) the universe of available managers is large and includes firms of all sizes and backgrounds (including emerging managers) and interaction with a diverse set of managers may bring unique insights to CalPERS Global Equity program.

First, as it is currently constructed, the externally managed portfolio has a distinct large cap bias compared to the US equity opportunity set. The chart below show the size and style characteristics of each of the current US equity managers and the Dow Jones Wilshire 5000, a broad US equity market benchmark that contains large, mid, small and micro cap stocks. This bias is off-set by a greater small cap weight in the Dynamic Completion Fund and therefore does not pose any additional risks to CalPERS' returns. However, given that most academic thought supports the idea that there are greater information inefficiencies and more potential for outperformance among small cap investors, this bias within the external manager group likely results in some opportunity cost for CalPERS.



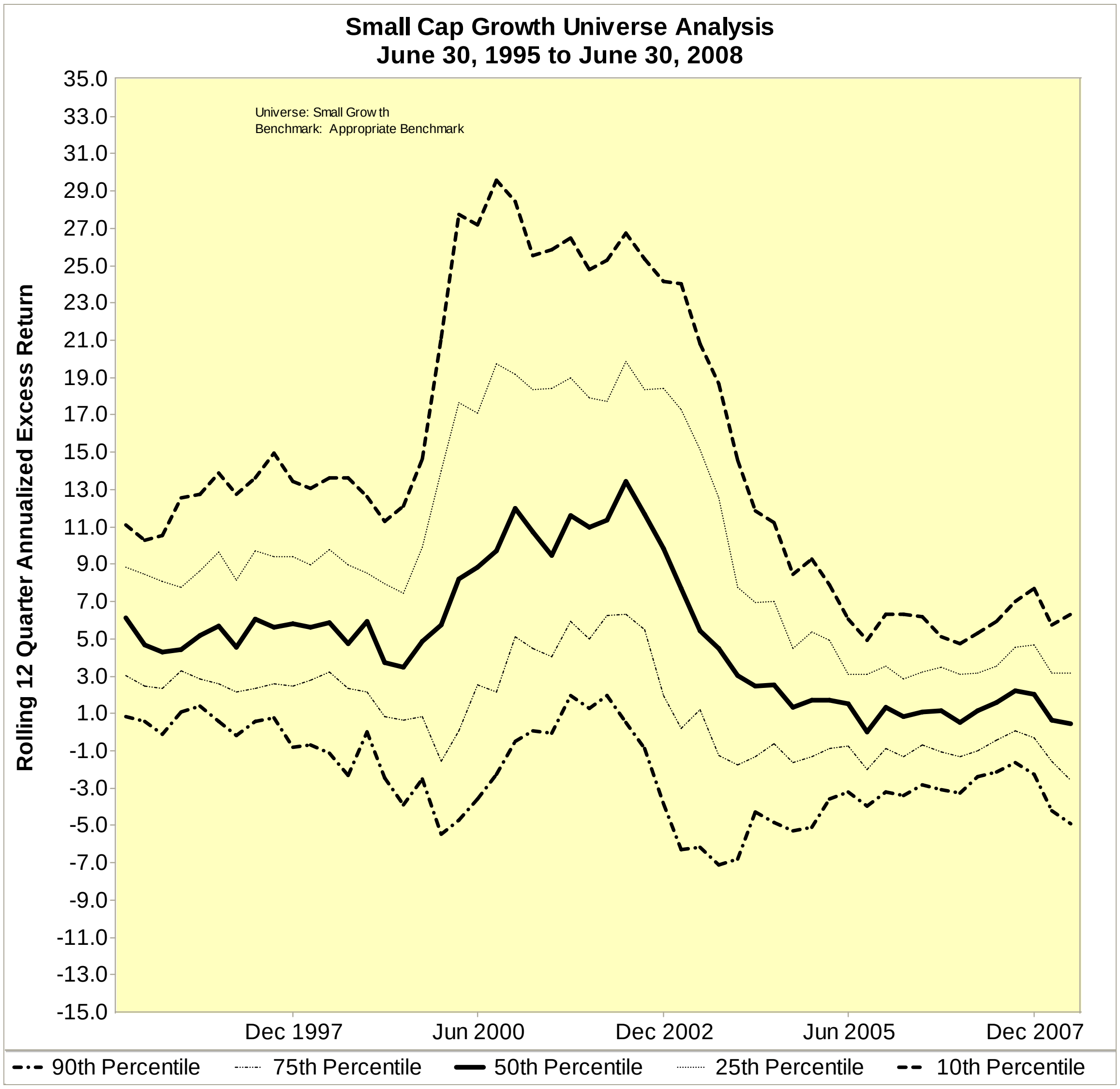
Note the lack of smaller cap managers in the externally managed portfolio. This is not to say that CalPERS has no exposure to smaller cap stocks. CalPERS currently has exposure to smaller cap stocks through it domestic equity index fund (benchmarked to a custom Wilshire 2500 Index, which includes large, mid, and small cap stocks) and its internally managed micro cap portfolio. In addition, as mentioned above, the Dynamic Completion Fund is designed to mitigate any size or style bias that is present in the external portfolios.

The graph below shows the total external US equity portfolio (rather than manager by manager) compared to the broad market. We have also included large cap, mid cap, and small cap benchmarks for comparison purposes.



The graph demonstrates that a large cap bias exists in the externally managed US equity portfolio. Again, note that this is ameliorated by other portfolios within the total Global Equity portfolio.

Next, Wilshire believes that the smaller cap spaces of the domestic equity market are less efficient than large cap and that active managers can add value. Presented below are graphs showing the excess returns generated by six different smaller cap universes of active managers, relative to an appropriate benchmark: small cap growth, small cap value, small cap core, mid cap growth, mid cap value, and mid cap core (listed in the order in which they are presented).


Small Cap Growth Universe Analysis
June 30, 1995 to June 30, 2008
Universe: Small Growth
Benchmark: Appropriate Benchmark
Rolling 12 Quarter Annualized Excess Return
35.0
33.0
31.0
29.0
27.0
25.0
23.0
21.0
19.0
17.0
15.0
13.0
11.0
9.0
7.0
5.0
3.0
1.0
-1.0
-3.0
-5.0
-7.0
-9.0
-11.0
-13.0
-15.0
Dec 1997
Jun 2000
Dec 2002
Jun 2005
Dec 2007
90th Percentile
75th Percentile
50th Percentile
25th Percentile
10th Percentile


Small Cap Value Universe Analysis
June 30, 1995 to June 30, 2008
Universe: Small Value
Benchmark: Appropriate Benchmark
Rolling 12 Quarter Annualized Excess Return
19.0
18.0
17.0
16.0
15.0
14.0
13.0
12.0
11.0
10.0
9.0
8.0
7.0
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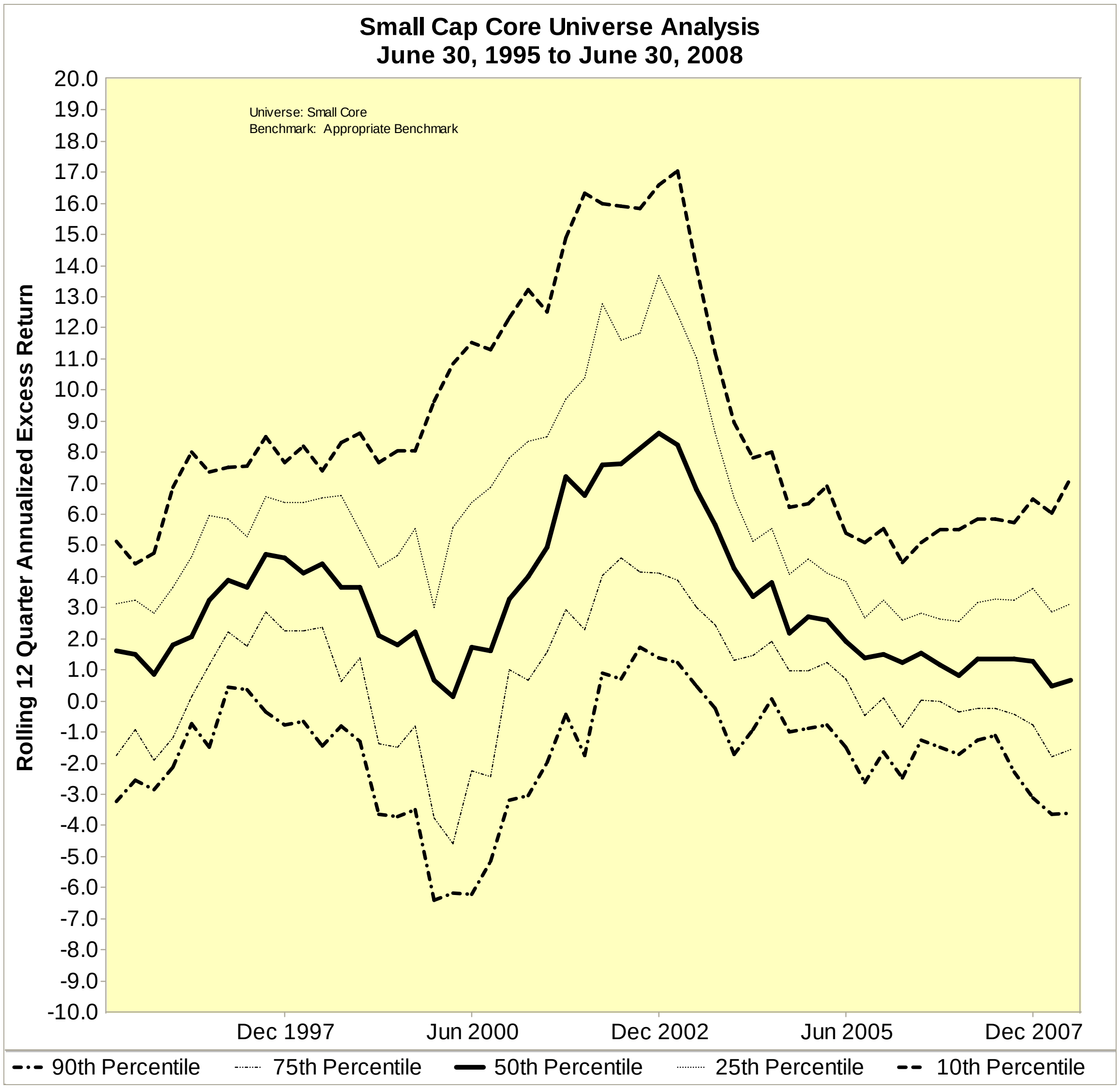
Small Cap Core Universe Analysis
June 30, 1995 to June 30, 2008
Universe: Small Core
Benchmark: Appropriate Benchmark
Rolling 12 Quarter Annualized Excess Return
20.0
19.0
18.0
17.0
16.0
15.0
14.0
13.0
12.0
11.0
10.0
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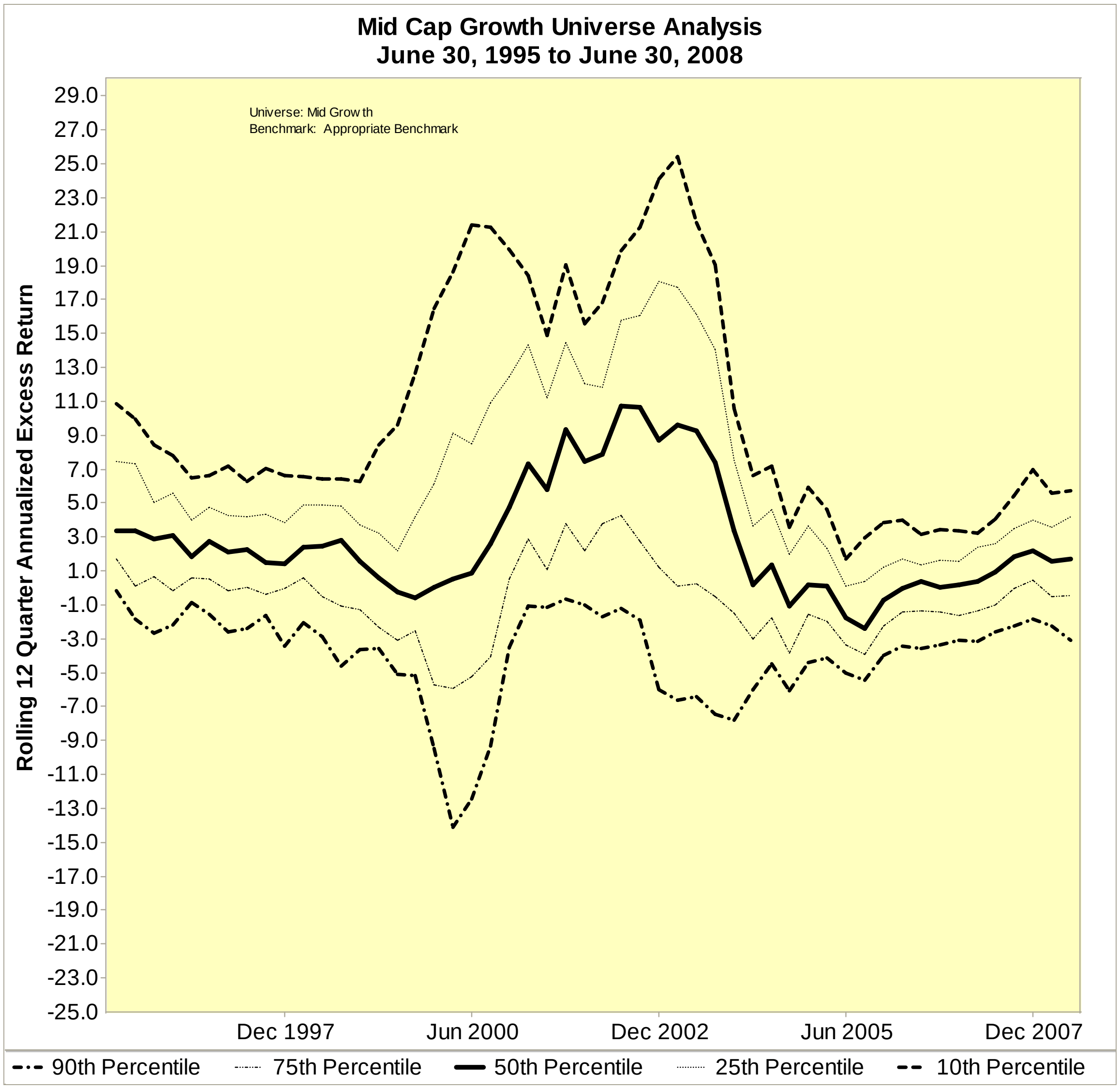
Mid Cap Growth Universe Analysis
June 30, 1995 to June 30, 2008
Universe: Mid Growth
Benchmark: Appropriate Benchmark
Rolling 12 Quarter Annualized Excess Return
29.0
27.0
25.0
23.0
21.0
19.0
17.0
15.0
13.0
11.0
9.0
7.0
5.0
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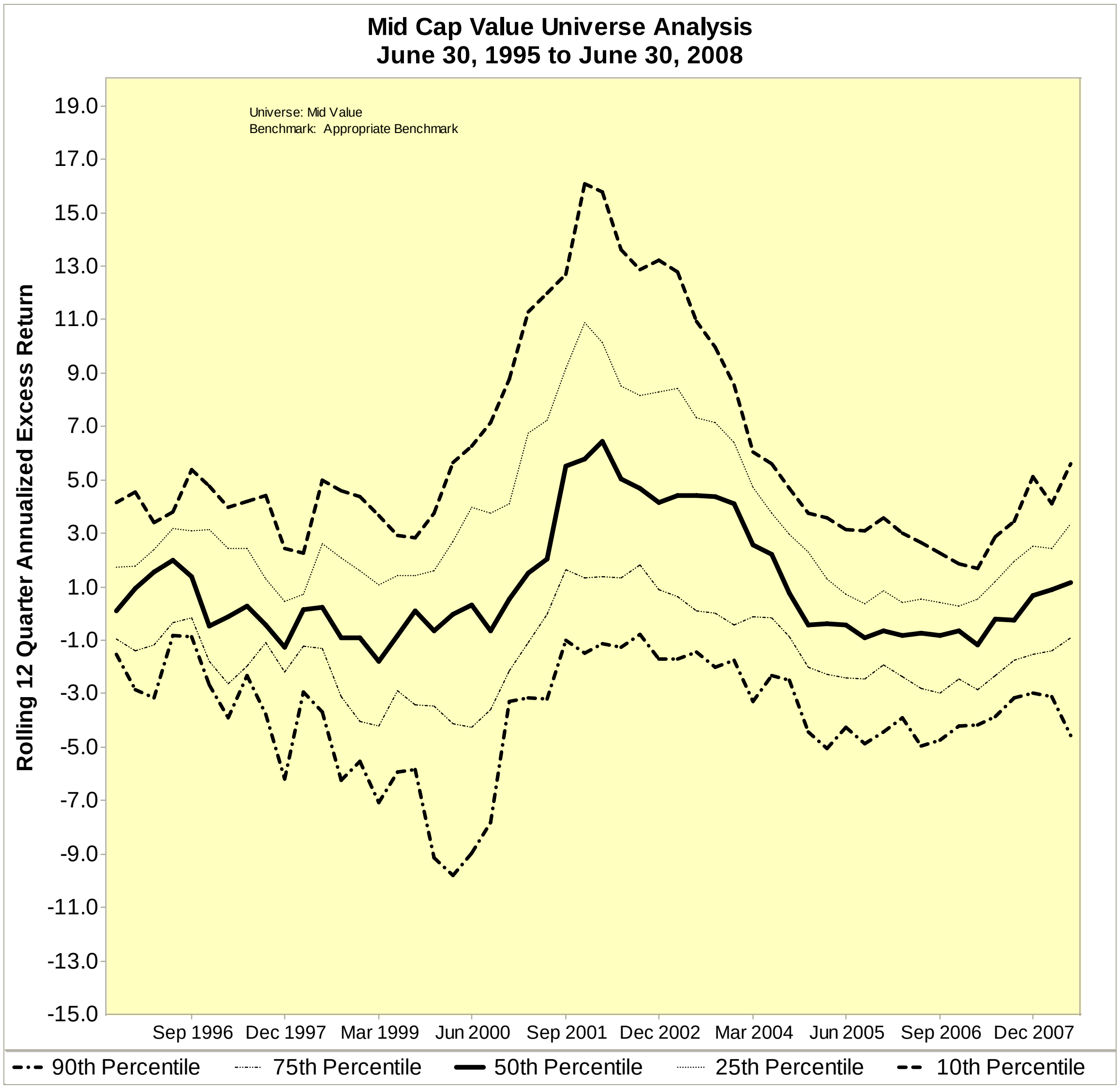
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Universe: Mid Value
Benchmark: Appropriate Benchmark
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Sep 1996
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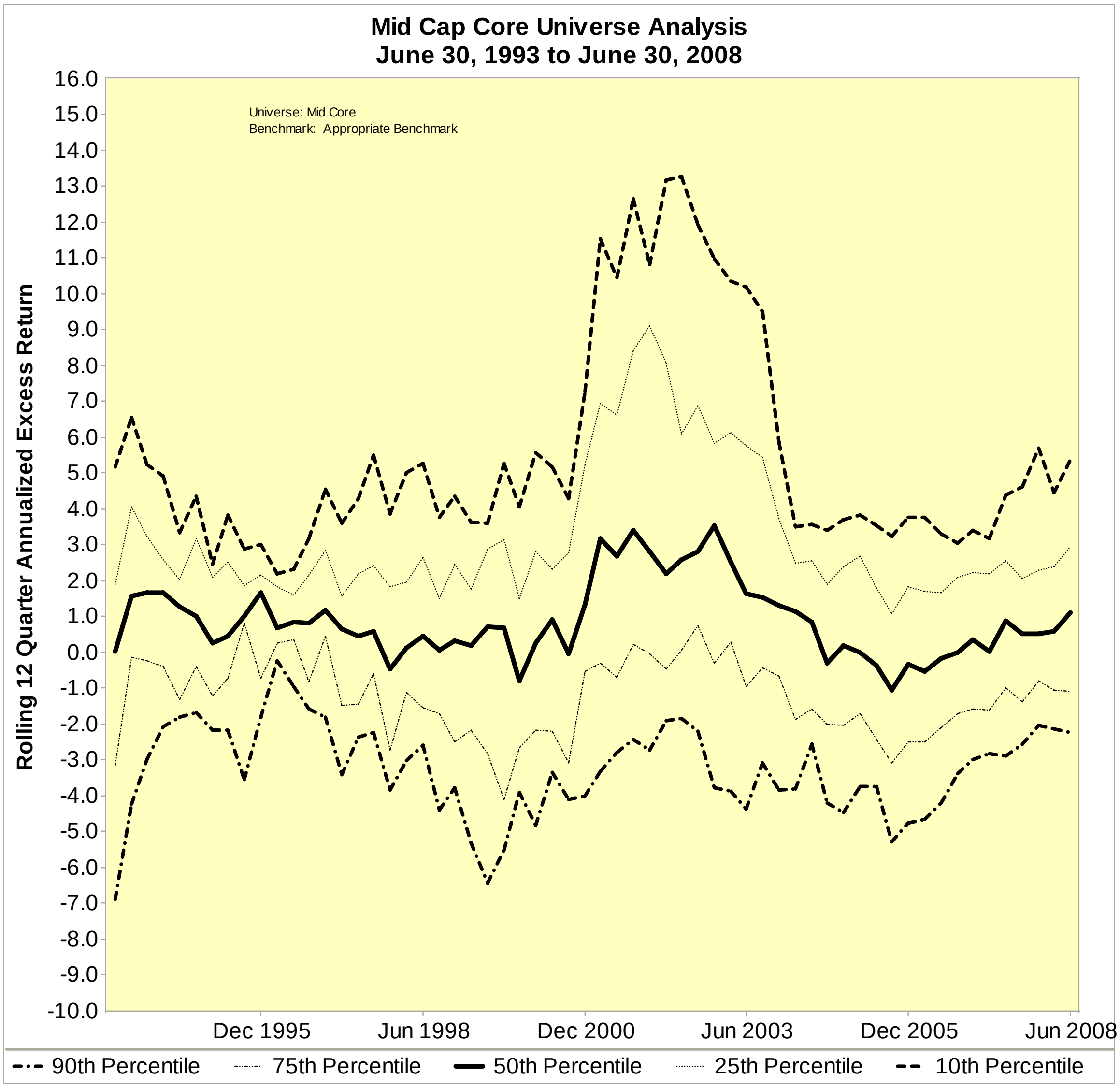
25th Percentile
10th Percentile



These charts demonstrate that the median manager frequently, although not always, has added value over the past ten years, when judged on a rolling three-year performance cycle. Specifically, the average excess return of the median manager over those time periods is listed below. In addition, the highest and lowest excess return generated by the median manager in each category is presented.

	Average	High	Low
Small Cap Growth	5.1%	13.4%	0.0%
Small Cap Value	2.3%	4.9%	0.3%
Small Cap Core	3.2%	8.6%	0.1%
Mid Cap Growth	2.8%	10.7%	-2.3%
Mid Cap Value	1.0%	6.4%	-1.8%
Mid Cap Core	1.0%	3.5%	-1.0%

Last, the number of available managers in the small and mid cap universes that have active management philosophies is large. At present, there are 506 different products that are in the small or mid cap universes in Wilshire's database, have three-year track records, and currently have separate account products that are open to new business. Additionally, 121 of those firms have firm-wide assets under management of less than $2 billion, which would generally qualify such firms as emerging managers.

In summary, we believe that CalPERS could benefit from further examination of the smaller cap domestic equity space using the current portfolio management process focusing on hiring talented managers with processes which are not easily replicable within CalPERS. The smaller cap space is generally less efficient, making active management an attractive alternative, and there appears to be ample opportunity in terms of the size of managers that have open products.

AllianceBernstein

AllianceBernstein is one of CalPERS' active managers using a value approach to portfolio construction. The firm utilizes a bottom-up approach for security selection that emphasizes the present value of each company's future cash flow. Using the cash flow analysis conducted by their analysts to calculate the present value of a company's future cash flows, AllianceBernstein compares the present value to the current price of the stock to find those companies that have the highest expected return. The strategy results in a portfolio that Wilshire considers "relative value" as opposed to "deep value." This relative value bias is also evidenced by the fact that AllianceBernstein constructs the portfolio with the S&P 500, a core benchmark, in mind rather than a typical value benchmark.

AllianceBernstein underperformed its benchmark for the fiscal year by 3.95%. Both sector weights and stock selection detracted from AllianceBernstein's excess returns.

Analytic Investors

Analytic is one of the CalPERS' 130/30 managers and was funded in 2007. Analytic's process is a risk-controlled, quantitative factor-based strategy that seeks to profit from buying long overperforming stocks and by selling short underperforming stocks.

Analytic underperformed its benchmark for the fiscal year by 0.49%. Analytic's returns were dragged down by stock selection, particularly during the 3rd and 4th quarters of calendar year 2007. This time period was particularly difficult for quantitative strategies as it marked the beginning of the deleveraging that has continued throughout the financial system.

The Boston Company

The Boston Company utilizes a value approach in managing this portfolio. The approach is based on fundamental analysis of individual companies. Internal research comprises approximately 90% of the total research effort. The Boston Company uses BARRA and Northfield risk management software to examine the risk profile of the portfolio on a weekly basis.

The Boston Company portfolio was funded in 1998 and has added 2.22% of return (annualized) since inception. The portfolio has outperformed its benchmark in each of the past six fiscal years. The Boston Company's performance was particularly strong in FY 2008, outperforming the benchmark by 8.20%. This outperformance was driven by strong stock selection.

First Quadrant

First Quadrant is one of CalPERS' newly-funded 130/30 managers. First Quadrant uses a quantitative multi-factor process. First Quadrant's process is unique in that it incorporates a top-down component in addition to bottom-up, stock–specific components that are traditionally used in quantitative processes. First Quadrant controls risk with sector and stock limits designed to control the tracking error of the product versus its benchmark.

Although CalPERS only has one full quarter's returns from this account, First Quadrant is off to a good start, outperforming by 4.41%. First Quadrant's excess returns were generated by strong stock selection, with outperformance in seven out of ten industries.

Golden Capital Management

Golden Capital Management is one of the success stories of the MDP program, having been transitioned out of the MDP program in late 2006. Golden uses a quantitative enhanced index strategy.

Golden's performance was strong as a part of the MDP program and has continued to perform well since transitioning out of the program. Golden outperformed its benchmark during the fiscal year by 1.12%, which ranks it among the top quantitative enhanced index managers for that time period. Golden's excess returns were driven by strong stock selection.

INTECH

INTECH uses mathematical models to manage this enhanced index portfolio. INTECH focuses on the volatility of stocks and the covariance of a stock's return with other stocks in the market. The firm does not use fundamental research of any kind, other than a very simple liquidity and bankruptcy screen. The portfolio's returns are driven by what they believe is a more efficient weighting of stocks in the index based on volatility and correlation and frequent rebalancing to this target weight. The firm rebalances the portfolio every six business days.

INTECH underperformed by 0.15% during the fiscal year. Stock selection for the year was marginally negative. Since inception, INTECH has outperformed its benchmark by 0.25%.

JP Morgan

JP Morgan manages a 130/30 product for CalPERS and was funded at the beginning of the 2nd calendar quarter of 2008. JP Morgan's product is unique in that it is based on fundamental research, rather than the quantitative models used by many other 130/30 managers. Risk is controlled through sector and stock limits which effectively constrain the targeted tracking error versus the benchmark. JP Morgan seeks to maintain a net exposure of 100% with a beta of approximately 1.0. In short, this strategy seeks to add value through security selection on the long and short side of the portfolio.

Although CalPERS only has one full quarter's returns from this account, JP Morgan is off to a good start, outperforming by 1.20%. JP Morgan's excess returns were generated by strong stock selection, which added 1.47% (sector weightings were marginally negative).

Marvin & Palmer

Marvin & Palmer manages an active, growth-focused product for CalPERS. The firm believes that equity returns are driven by a combination of market and fundamental factors, and the firm addresses both sets of factors through its top-down and bottom-up research. The firm believes that stocks and sectors move through cycles that last between two to four years. Marvin & Palmer seeks to identify these trends early and follow the trends for the remainder of the cycle.

Marvin & Palmer significantly outperformed during the fiscal year, adding 12.58% of value above the benchmark. During that time period, both sector weights and stock selection contributed to Marvin & Palmer's outperformance, but stock selection was the primary driver adding more than 11% in value.

Pzena

Pzena manages an all-cap value portfolio for CalPERS. The firm uses a bottom-up approach to security selection and runs a fairly concentrated portfolio, which has ranged between 35 and 41 stocks since inception. Pzena's approach is deep value and the product focuses on the "cheapest" quintile of a 1,500 stock universe. Pzena seeks out-of-favor companies where the firm feels there is a disconnect between the stock price and the company's normalized earnings. Pzena is willing to have significant "bets" relative to the index and consequently has a very high tracking error.

Pzena was funded in 2000 and has outperformed by 1.13% since inception. Fiscal year 2007, was a good year for Pzena, when the portfolio outperformed by almost 7.0%. However, this past fiscal year was very difficult as Pzena underperformed by 14.64%. Stock selection and sector weights both contributed to the underperformance, but sector weights were the main detractor, subtracting approximately 15% in returns. This was largely due to Pzena's sector weights versus the benchmark. For example, during the 2^{nd} quarter of 2008, the portfolio held no energy stocks, the best performing sector of the market, while the index had a 17% weight. The void in Energy stocks during the second quarter caused more than 3.5% of relative underperformance. However, as noted above, Pzena has added value in total since inception. Wilshire will continue to closely monitor this manager.

Quantitative Management Associates

QMA manages a 130/30 portfolio for CalPERS using a quantitative approach. Different factors are examined for different types of companies: valuation metrics are used for slow growing companies and news-based metrics are used for fast growth companies. Risk controls are very tight with stock, industry, and sector weights constrained to reduce tracking error.

During the fiscal year, QMA underperformed its benchmark by 0.57%, with most of the underperformance driven by stock selection during the quant deleveraging that occurred in the second half of calendar 2007. During the second calendar quarter of 2008, QMA added value as the market began to recognize that fundamentals matter in equity selection.

T. Rowe Price

T. Rowe Price (TRP) manages an enhanced index portfolio for CalPERS that is driven exclusively by the fundamental analysts that TRP employs. TRP has more than 30 different analysts covering various industries of the stock market. Each analyst selects which stocks the portfolio will own in the industries that they cover based on the analysts' evaluation of the company. TRP has a team that oversees the portfolio construction process and manages the sector weights and position limits to constrain the tracking error.

TRP outperformed its index by 1.55% during the fiscal year, aided by strong stock selection throughout the year. Since inception, TRP has added 1.16% return above its benchmark.

Turner

Turner manages an active, growth focused portfolio for CalPERS. Turner pursues a bottom-up strategy that blends quantitative research, fundamental research, and technical analysis, with an emphasis on fundamental research. Turner looks for growth companies with strong earnings prospects, reasonable valuation, and favorable price and volume characteristics. Turner's fundamental analysis focuses on how a company's earnings are likely to fare relative to the consensus estimate. This particular product aims to be sector neutral to the S&P 500, which is a core benchmark, as a method of controlling risk but stock selection is purely focused on growth stocks.

Turner outperformed its benchmark during the fiscal year by 0.48% and has outperformed since inception by 1.84%. Turner's returns have been driven by strong stock selection across the board.

Conclusion

While Wilshire is closely watching two of the above mentioned managers, Wilshire concurs with Staff's recommendation to renew the contracts for all of the external active domestic equity managers and the external enhanced index domestic equity managers. CalPERS does have the right to terminate any of these managers with 30 days notice, if the need arises. Wilshire will continue to monitor these managers over the coming months.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,